

## West Midlands Pension Fund – CTI case study

The West Midlands Pension Fund (WMPF) has been on a five-year mission to better understand its investment costs. In doing so, the scheme has enhanced its governance, been able to make more informed investment decisions and now has greater visibility on how costs may evolve as the strategy changes over time.

Back in 2014, WMPF developed in-house cost disclosure templates for its fund managers to complete. Based on its experiences from those early templates, the WMPF has since helped to pilot the industry-wide Cost Transparency Initiative (CTI) model and is now an influential advocate of CTI.

“Using first our own templates then the CTI approach, we have been able to identify and manage our costs much more effectively,” says Rachel Brothwood, Director of Pensions at WMPF. “Over the last five years, we’ve seen a 50% reduction in costs, from over 80 basis points to under 40.”

Brothwood says that the CTI model has two key advantages over WMPF’s earlier in-house approach. “The templates enable us to capture a broader range of costs, in a standard format. We were initially collecting information just based on what our managers could provide. Now, we can capture a much wider and more consistent range of data points, capturing more previously unseen areas such as transaction costs, for example.”

“A consistent set of templates also makes it easier for the investment community to respond,” adds Brothwood. “This has been reflected in the rate and volume of responses we’ve received since using CTI. We sent out over 200 templates this year, and these have been returned more quickly and covered more of our assets than ever before.”

The WMPF now has in-depth details on the management costs of over 90% of its assets, based on the CTI templates. Most of the remaining 10% is in private, illiquid markets where fund managers’ awareness of the CTI model is less well developed than in public markets, and where processes for CTI-related data reporting may not be as well established.

However, Brothwood says that private markets are now taking heed too: “As this process becomes the norm, managers will be expected to provide the required information. Compliance with CTI is part of our investment process and decision-making now, so if a manager can’t commit to cost transparency, that may be a red line to their appointment.”

The benefits of better-quality cost data are clear. Says Brothwood, “From a governance perspective, we want to make sure we are executing due diligence by collecting and analysing our costs. That way we can make sure we are not leaking value within the portfolio. However, there can be a perception that this is just about hammering down costs. It is more about understanding them, so that we can clearly justify spend where it adds value.”

That helps to inform investment planning and decision-making for WMPF. “At a total pension scheme level, our costs are linked to our asset allocation, which will change as the scheme matures. As we look more for yield from illiquid asset classes and allocate more to sources of income to pay

pensions, we know that we are likely to see an increase in costs. The outputs from the CTI model are good groundwork for being able to understand the potential transition.”

Similarly, Brothwood says that the insights CTI templates provide have helped to support the evolution of WMPF’s responsible investment strategy. “Responsible investment is an important part of our strategy but where you have more intelligent portfolios, you often see added cost. From a financial risk perspective, we need to balance our duty to pay pensions and meet our long-term funding requirement through returns net of cost, accepting more sophisticated sustainable strategies may come with added cost. . With more insight into our fund manager costs, we are in a position to make an informed decision on our approach.”

Brothwood believes schemes that aren’t yet using the CTI templates are missing out on opportunities to review cost and increase confidence in the efficient implementation of their investment strategies. “CTI forms part of good governance and investment stewardship. Plus, in the Local Government sector, we have increasing disclosure requirements. Not being able to report accurately on costs will become ever more of an issue over time as we remain focused on delivering a cost-effective Scheme for our employers and members.”